

ECJ: Limiting the Interest Deduction for an Intra-group Loan Is Compatible with EU Law

News

Thomas Wahl

On 4 October 2024, the ECJ ruled in [Case C-585/22 \(X BV/Staatssecretaris van Financiën\)](#) that a Member State can refuse to deduct tax on interest costs with reference to abusive tax practices to the extent that the interest is not at arm's length. The [ECJ found](#) that the Dutch provisions on abusive tax practices can act as a deterrent to the exercise of freedom of establishment. However, it recognised that these legal provisions constitute a permissible restriction on the freedom of establishment and pursue a legitimate objective of combating tax evasion. This objective also applies to cases in which an entity only becomes an entity related to the same taxpayer as a result of the acquisition or increase of a shareholding (present case).

The Court also stated that the taxpayer can rebut the presumption that the interests paid constitute or form part of "wholly artificial arrangement" by comparing it with normal market conditions. In order to check whether the requirement of arm's length is met, the economic reality of the transactions must be taken into account.

If the artificial nature of a transaction results from an unusually high interest rate on such a loan, which otherwise reflects the economic reality, the principle of proportionality requires that the proportion of this interest paid that is above the normal market interest rate be deducted. By contrary, if the loan is, in itself, devoid of economic justification and, but for the relationship between the companies and the tax advantage sought, would never have been contracted, it is consistent with the principle of proportionality to refuse the deduction of the whole interest.

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